

Property Tax Reappraisal Committee

January 12, 2004
Room 317 C, Capitol

MINUTES

Please Note: These are summary minutes. Testimony and discussion are paraphrased and condensed. Committee tapes are on file at the Department of Revenue. Exhibits for this meeting are available upon request.

COMMITTEE MEMBERS PRESENT

Rep. Ronald R. Devlin, Chair
Sen. Emily Stonington, Vice Chair
Sen. Robert R. Story,
Sen. Ken Toole
Rep. Rod Bitney
Rep. Gary Branae
Rep. Larry Cyr

COMMITTEE MEMBERS EXCUSED

Sen. Greg Barkus

STAFF PRESENT

Dolores Cooney, Department of Revenue
Rocky Haralson, Department of Revenue
Dorothy Thompson, Department of Revenue
Marion Mood, Secretary

AGENDA & VISITORS

Agenda (ATTACHMENT #1)
Visitor's list (ATTACHMENT #2)

COMMITTEE ACTION

CALL TO ORDER AND ROLL CALL

Chairman Ron Devlin called the meeting to order at 1:15 p.m., and the secretary noted the roll (see above). **Chairman Devlin** lauded the progress made during the morning's joint session and asked if anyone wanted to comment on some of the items discussed; no comments were offered. Since the minutes from the November 21, 2003 meeting had just been provided to the committee members, **Chairman Devlin** advised postponement of their approval until the next day to allow time for review.

Next on the agenda was the budget review, and **Chairman Devlin** noted that based on information from the morning's joint session, the cost per single day meeting was approximately \$1,500; he advised the cost for a two-day meeting would be 1 ½ times that rather than twice the amount and therefore more cost effective. He suggested arriving at a work plan which would establish the number of future meetings needed to accomplish the committee's goals, noting that following the elections in November, many of the committee members would be busy attending caucuses and wrapping up other committee activities, and December was historically a bad month for scheduling meetings. He felt the end of October would be optimal for their work to conclude and asked for input with regards to deadlines for drafting legislative proposals. **Sen. Robert Story**, thought interim committees had to have their legislative proposals in by the end of September. **Leanne Kurtz** advised the deadline for interim committees was September 15th but this committee operated under the rules of the Legislative Council, and any legislative requests would have to come either from one of their members or be made through the Department of Revenue. **Sen. Story** surmised the committee's work would have to be completed by August, and any legislation would have to be made through individual sponsorship. **Dolores Cooney** asked **Chairman Devlin** what he anticipated in the way of individual sponsorship or effort by the committee as a whole. He replied that in the event the committee missed the deadline, they would certainly try and designate a legislator in either chamber to carry the proposed legislation. **Chairman Devlin** remembered an earlier reappraisal committee, which had worked right up to the beginning of the last legislative session, and he asked if it had been a Department of Revenue committee, subject to the Legislative Council rules. **Sen. Story** stated this was a committee appointed by the Governor and produced individual legislative requests as well. A discussion ascertained the legislative requests did not have to be made by a member of this committee but could be made by any legislator. **Chairman Devlin** asked whether a conclusion of their work by August was acceptable to the members or whether they wanted to go to mid-October, and how many meetings they felt were necessary to accomplish their goals. **Ms. Cooney** had suggested to pick an end date, determine how many meetings it would take to complete the work, and establish future meeting dates based on the agreed upon work plan. He asked if anyone had a preference as to the final month. **Sen. Ken Toole** wanted to see it end sooner rather than later because of other legislative obligations. **Chairman Devlin** advised if it became necessary to go into October, it would be close to the beginning of the month. **Sen. Story** suggested the committee plan on ending in September and if need be, to go into October; **Chairman Devlin** agreed, setting the ending date as September 15th. **Ms. Kurtz** noted this would also be the deadline for a final bill draft as well as a committee report prepared by the staff.

Chairman Devlin invited **Ms. Cooney** to speak to recent changes in the Department of Revenue and how they would affect any requests for information by this committee. Following is her report:

- The Property Assessment Division had lost 7 FTE's at the beginning of the year due to the second part of last session's budget reduction;

- Out of the current crew of eight, two retired and two more were due to retire within the next six months;
- The process of rebuilding the division would effect a delay in providing requested information;
- Due to the reassignment of **Judy Paynter** and two other staff positions from Tax Policy and Research to the Governor's Budget Office, they had lost **Ryan Jose** who was key in analyzing the databases;
- **Brad Simshaw** retired;
- **Larry Finch**, the new administrator for Tax Policy and Research, was in the process of recruiting for the position of a property tax analyst who would produce the kind of analysis the committee needed in order to make policy decisions. She anticipated it would be May before good data could be furnished.

Chairman Devlin expressed the need for developing a work plan; he asked if the members wanted to continue focusing primarily on Class 4 property or include other classes in their discussions as well. **Sen. Story** opined the world would not come to an end if they did nothing but it would leave issues unsolved for the next Legislature. This group's main focus was reappraisal, and parameters needed to be set as to how broad the assignment should be. He outlined three approaches:

1. Do nothing now and leave changes in the appraisal system up to the Legislature;
2. Adopt Mr. Stack's approach by looking at how other states were dealing with the 'limited increase' idea;
3. Develop statutes that would accomplish this, keeping in mind the state's constitutional limitations.

He went on to say they should take a look at a 2% or 3% increase, as well as get a perspective on what was already happening in all of the classes. Will a 2% annual increase in residential and commercial property present an equity problem for the other classes? He felt it might not, depending on the growth rate and asked if the Department would furnish growth rate data for all classes so the committee could make a comparison. If the growth rate in all other classes was only 1% or 2%, there would be no problem in holding Class 4 to 2% or 3% growth with regards to class equity; in fact, it would be superior to the present system. He speculated if a 2% growth cap were put in place and everyone was given a reduction, some jurisdictions would have growth while others would not. He proposed it was a workable solution which would help overcome the political problems of the inequities currently in Class 4; he felt while these inequities did not exist in the other classes, it would be helpful to get more information on them.

Sen. Emily Stonington asked if he thought the 'exemption for land' idea was worth pursuing, which **Sen. Story** affirmed. **Sen. Stonington** agreed with **Sen. Story** in that it would be a good idea to pick several projects and take an in-depth look at them, such as the idea of limiting the increase in appraised value; the exemption for land; the sales ratio approach advocated by the DOR; and the impact it will have when the business equipment tax goes to zero. She was curious about the implications with regards to the other property classes if and when that happened and felt it should be discussed. **Rep. Rod Bitney** asked if it was probable that the business equipment tax would actually go to zero. **Sen. Story** replied it would not happen in the coming year and depended on certain

triggers; he allowed that this point could be reached in May. **Sen. Toole** recalled an earlier discussion involving revenue projections, saying if the presenter was right, the trigger could begin the tax rate reduction to zero in May. When quizzed, he explained that the discussion was led by an economic projection group under contract by the state. **Chairman Devlin** stated it had come very close after the session last year due to a very low inflation rate coupled with slow growth. He stressed as the committee was looking at the total bundle of taxes, this was something they had to take into account because if one went to zero, it would affect the others. He reiterated the three issues on the table:

- The business equipment tax going to zero;
- A possible reduction of another tax; or
- **Sen. Story's** scenarios of separating the structure from the land; capping the growth; or doing nothing.

He asked the committee to decide how many meetings it would take to work on and resolve these issues, keeping in mind that the DOR would not have their staff situation up to par until May. **Sen. Toole** requested more information on 'reverse mortgage' or building tax liability against the property until it is sold; he was concerned with people of limited income seeing the value of their homes escalating rapidly and not being able to afford the higher taxes on them; he wondered if it was possible to pay the accruing taxes through a reverse mortgage until the property changed hands, when they actually benefited from the increased value. **Sen. Story** thought there was such a program in place already which **Ms. Cooney** confirmed, saying it was geared toward the elderly. **Sen. Toole** recalled a conversation with **Brad Simshaw**, which made it apparent that the program alluded to, worked differently than the one he had in mind. He felt that in the program for the elderly, the tax debt accrued against its value until the property's sale; what he had in mind was a payment up front to the homeowner. Lastly, he wondered if interest charges would come into play on the accrued debt. **Chairman Devlin** pointed out the committee had eight months in which to finish its work and asked how many meetings it would entail. **Ms. Cooney** surmised there were several main issues being discussed, namely the study of what was happening in the other classes; *[Tape 1, Side B]* the impact of the business equipment tax going to zero (she offered the Department could work on that without having its full staff in place); and an in depth study of what would happen with the land exemption. **Sen. Story** recalled this information was available albeit four years old, and it made assumptions as to what would happen in all the other classes. **Ms. Cooney** summarized this would be the basic information to be provided at the next meeting. She added she had information on the Michigan/Florida solution to get a discussion started now but cautioned it would require an in-depth look at a future meeting because it would be difficult to take another state's solution and assimilate it into Montana when the tax and tax rate scenarios were different. She suggested a May meeting to discuss in more detail and align the ideas coming out of this and tomorrow's meeting; a meeting in June to outline legislation, and one in July or August to begin drafting legislation. **Chairman Devlin** added the final meeting was slated for September, bringing the total to four. **Ms. Cooney** stated her office would provide whatever was needed for any of the meetings. **Chairman Devlin** said he had no problem waiting until May for the next meeting; he envisioned a multiple day meeting which would not only be

more productive but also stretched the committee's budget. In the ensuing discussion, **Sen. Story** advocated meeting sooner than May and trading one of the fall meetings for it; he felt it was important to study the Michigan/Florida issues and suggested either a phone or video conference with key people there to learn as much as possible or to find other means of developing an interactive presentation, adding that at this point, this committee did not even know precisely what questions to ask of them. **Ms. Cooney** stated they had a key contact in Ken Wilkinson in Florida and another in Michigan; she was certain they could be asked to work with the committee in some form or another. **Sen. Story** cautioned it would be too costly to bring anyone into the State. **Rep. Bitney** voiced the same concerns, saying he would favor an earlier meeting and concluding sooner than October. **Rep. Gary Branae** agreed. **Chairman Devlin** asked **Ms. Cooney** to review the issues and their time frames, saying a meeting could be scheduled between now and May for which the DOR could provide the necessary information even if their staff situation was not resolved yet. In the event of a March meeting, **Ms. Cooney** advised she could definitely furnish the background for a discussion about the other property classes, and the impact of the business equipment tax going to zero; the committee could begin preliminary work on the 'reverse mortgage' concept and view what other states were doing with it, and they could start looking at the solutions Florida and Michigan had adopted. She stated the Department could have a detailed analysis ready for a March meeting, but the statistics showing its impact on the tax bases and information on the land exemptions would not be ready until the June meeting.

Sen. Story asked whether county level data were available from the last reappraisal on the number of tax increases or decreases for residential property, which **Ms. Cooney** affirmed. He stated this kind of analysis was needed in order to find out about the tax base in a community. **Ms. Cooney** replied the Department needed until the June meeting to come up with data for the tax level. **Chairman Devlin** concluded a March/April meeting should be scheduled at which the issues listed by **Ms. Cooney** would be discussed; he also wanted to include a closer look at the state of Oregon. **Ms. Cooney** stated there were five to seven other states, which were dealing with this and reminded the committee of a pertinent article she had sent to them. While **Chairman Devlin** recalled having received information on Michigan and Florida, this morning's meeting was the first time any reference was made to Oregon. He advised the agenda for the May/June meeting would include an in-depth analysis of tax consequences at the county level or lower under the scenarios of doing nothing, putting a cap in place, and/or separating the land from the structure. He stated if the structure was taxed at 100% of value, and a separate determination was made on a percentage for the land on which the structure was built, things could get fairly complicated. **Rep. Bitney** injected there actually were three issues, namely the status quo, an incremental increase, and the acquisition value. **Sen. Story** asked whether any of the members felt it important to spend time on acquisition value. **Chairman Devlin** thought this aspect did not warrant further study, the main issue was how to deal with rapidly increasing property values. He asked for further input for the July/August meeting, saying the committee should refine and review the issues at that time and determine whether or not any legislation would be drafted. As far as the September meeting, the report would be issued, and any legislation would have been started. A discussion ensued between the chairman and **Ms. Cooney**

regarding the March meeting date and place; it was determined it would again be at the MACo building, and depended on the other members' schedules. **Sen. Toole** injected that if the committee wanted to talk to the contacts from Florida and Michigan, it would be worthwhile to look into teleconferencing which then would require finding a suitable location; he would prefer being able to interact with them but stressed the committee members should first arrive at an understanding of the other states' systems. **Sen. Story** recalled having used MetNet during the last Special Session but disliked it because it was too slow and complicated and required more than one TV; he preferred VisionNet. **Rep. Bitney** agreed and added the group should reserve the option to invite these people here if it was not cost prohibitive. **Chairman Devlin** stated they would be ready for this at the July/August meeting at the earliest and suggested starting a dialogue prior to it in order to have a list of questions ready. He cautioned if they were to impose caps and thus limit growth, it would result in the necessity of further mill levies, which would defeat the committee's purpose. **Sen. Story** suggested it would be better to have an early morning interactive video presentation in May by representatives of the two states and ask questions of them at that point, and if more questions came up after deliberation, then they could be brought back for another round in the afternoon. When **Chairman Devlin** suggested adding this into the work plan, **Sen. Stonington** asked to set a date for the March meeting to make sure it would not conflict with anyone's schedule since most of the members served on one committee or another. Leann Kurtz volunteered to get the calendar for Revenue & Transportation to preclude conflicting dates.

[Tape 2, Side A] After checking their schedules against the calendar, the committee tentatively agreed on Thursday, March 4th for the next meeting. More issues could be added to the work plan, but as it stood, four additional meetings would be required with the May/June session likely being a two-day meeting.

The next item on the agenda was a nine state comparison of residential property taxes which **Sen. Barkus** had requested. Based on the committee's request to do a multi-state comparison for a \$200,000 home, **Ms. Cooney's** office had prepared three spreadsheets, **Exhibit 1**. The first page shows the analysis, the second touches on such aspects as whether the other states have a sales tax in place, and whether their property taxes are used at the state or local level. She offered to walk through the material and invited comments and questions.

- She explained they had taken *Helena, Montana*, as the baseline: a \$200,000 home's current tax liability was just under \$3,000, with the taxable valuation rate being 3.46% and the effective tax rate being right at 1.5%.
- In *Denver, CO* which has a sales tax, a house of the same value and without any homestead exemption has a tax liability of \$1,096, a taxable valuation rate of 9.15%, and an effective tax rate of .55%. She pointed out that Colorado's mill levy was at 59 mills whereas Helena's was 62 mills.
- *Florida* has the Save Our Homes initiative, and thus the property is capped at 3% as long it is owned by one party; when it is sold, taxes are based on market value. Moreover, *Florida* does annualized sales ratio studies, e.g. they have an annualized reappraisal. Since the house in the example was sold, the tax liability was \$3,763; had it not been sold, the tax liability would be lower due to the cap. **Sen. Toole** asked

to have the formula restated: taxable (appraised) value x mill levy = tax liability; **Ms. Cooney** explained that any applicable exemptions, such as Montana's homestead exemption, and/or taxable valuation rates are applied to arrive at the taxable value which is then multiplied by the mill levy to produce the tax liability. Referring to the comparison chart, she stressed that unlike Montana, all of the states listed had alternative revenue sources. **Sen. Story** contradicted by saying Montana also had alternative revenue sources, such as the various fees local government assessed as was pointed out in an earlier presentation about the cities' share of property taxes. He was certain other states had similar charges in addition to their sales tax. **Ms. Cooney** clarified her use of the term 'alternative revenue' referred to sales tax and local government funding only. **Sen. Toole** asked why some states' taxable valuation rate was at 3% while others' was 100%. **Ms. Cooney** replied it had mostly historical reasons; she referenced MACo's idea to use 100% as a base and calculate from there. **Sen. Story** added the rate depended on what was being done with all other property classes. **Ms. Cooney** went on to say the Department had checked if any of these states were doing anything special with regards to areas with rapidly rising property values, such as the resort communities of Jackson Hole, WY or Sun Valley, ID, and they had not found any special considerations. She added all of these states were facing the same issues as Montana, and only Florida and Michigan were starting to place caps on value increase. **Sen. Story** wondered how many states applied a percentage of the property tax to jurisdictions other than the one where it was collected. **Ms. Cooney** explained this statistic was contained in the last part of the 3-page handout; in Colorado, for example, the state did not get any portion of the tax, all of it stayed at the local level and its schools; in Florida, however, a portion did go to the state.

- *Boise, Idaho*, handles their tax much in the same way as Colorado, except they apply a 50% or \$50,000 homestead exemption, whichever is less, and their taxable valuation rate is at 100%. After applying a mill levy of 163, the tax liability is \$2,446 on a \$200,000 house.
- *Lansing, Michigan*, has a system similar to Florida's in that an owner-occupied home is held to a certain percent of increase; there again, if the house sold, it is re-appraised at market value.
- *Bismarck, North Dakota*, does not have a homestead exemption, its taxable valuation rate is 9%, its taxable market value is at 50% of appraised value (indexed by an annual ratio study), mill levy stands at 482 and the taxable value computes at \$4,243.
- *Pierre, South Dakota*, does not have a homestead exemption, either; taxable valuation rate is at 100%, their taxable market value stands at 85%, mill levy is 19.5, and the tax liability then is \$3,315.
- *Salt Lake City, Utah*, has a homestead exemption of 45% or \$90,000, taxable valuation rate is 100%, mill levy (they call it tax rate) is 144, and the tax liability is \$1,584.
- *Cheyenne, Wyoming*, has no homestead exemption; however, their taxable valuation rate is 9.5%, the mill levy 76, and the tax liability \$1,444.

In conclusion, she noted the committee should look at each state as a whole to compare how their tax structure worked, before adapting any part of their systems into Montana.

Chairman Devlin pointed to the disparity between mill levies and asked whether the K-12 education was funded through property tax in any of these states as it was in Montana. He noted there was some school funding inequity in this state with property values being lower in some of the Eastern regions than in the West, and therefore, people expected higher property taxes to be paid in the West. **Ms. Cooney** promised to amend the handout accordingly but stated it was difficult to see how much of the tax collections went to each state. **Rep. Bitney** wondered if there were different tax rates for second homes in the states listed in the comparison chart. **Ms. Cooney** was not sure and promised to research this, advising the homes in the chart were primary homes. **Sen. Story** pointed to the fact that these homes were owner-occupied and would not get the exemptions otherwise. **Ms. Cooney** agreed, saying this was true for Michigan and Florida as well. In Montana, exemptions apply to all residential properties, whether owner-occupied or not. **Sen. Story** wanted to know whether all of these states treated commercial properties the same as residential, or if they had residential and commercial properties in the same class. **Ms. Cooney** declined knowledge and said she would follow up on this.

Sen. Stonington asked whether the owner-occupied vs. non-owner-occupied status was a political or a constitutional decision. She recalled the cabin issue to have been a political issue, and **Sen. Toole** added a distinction had also been made between the exemption for a rental versus a homestead. **Sen. Story** advised the Landlords Association had convinced the Legislature it was not good policy to extend big tax breaks to homeowners and exclude rentals. **Chairman Devlin** stated that rental units fall under a different tax system than owner-occupied homes. **Rep. Bitney** noted that virtually all of the cities in the chart were larger than Helena and wondered how a \$200,000 home in Billings would compare to them. **Ms. Cooney** affirmed her office would provide a follow-up to the chart, noting their taxes would be less because their mill levy was lower than Helena's. **Sen. Story** added Billings had a charter limiting them to 75 mills, and anything above this limit required a vote by the constituency. **Ms. Cooney** commented she had sent out a guide to property taxes which contained information on commercial property tax structure and what classes other states assigned; she would provide this to the members in an easier format. **Chairman Devlin** referred to a provision Michigan had, namely that a homestead property was exempt from the basic local school district operating tax; he wondered if this had come about in the new legislation or if this law had existed before. **Ms. Cooney** advised this was a question the committee needed to ask of a Michigan representative. **Sen. Stonington** seemed to remember they had made this a constitutional change.

Chairman Devlin, having had a chance to look over the Revenue calendar, set the next meeting for Thursday, March 4th, at the MACo Building; the only meeting conflict might present itself in September when Revenue/Transportation met on the 9th and 10th. If this committee wanted to conclude by the 15th, they would have to work around it. The committee was ahead of schedule and decided to hear **Rep. Larry Cyr's** presentation.

[Tape 2, Side B] **Rep. Cyr** read the underlined portions of his handout, *Exhibit 2*, an article by Dr. David Brunori, published in the December '03 issue of **Governing** magazine. It talked about the steady decline of property tax in localities nation wide, and what alternate methods could be substituted, stressing local option sales tax and income taxes proved not to raise enough funds to sustain local governments. It warned localities would come to rely on the state for a greater portion of their funding which was a dangerous trend, creating fiscal uncertainty for local governments: when states run surpluses, there is always pressure to cut taxes rather than increase spending on local public services, and when states run deficits, local aid is among the first expenditures to get slashed. The author felt the only dependable revenue source for localities was the property tax, and it needed to be strengthened. Property tax is visible – citizens know what they are paying and can evaluate what they are getting in return. Another point he made dealt with the problem of exempt properties: exemptions for economic development and charitable organizations cost local governments billions of dollars and shifted the burden of paying for public services to other taxpayers. Lastly, he charged states must address the problem of inequities in financing education; control must remain at the local level, and methods of equalizing school spending which do *not* include reducing local taxing authority, must be found. Finally, the author talked about the benefits of split-rate taxation whereby improvements are taxed at a lower rate than the land.

Chairman Devlin commented the above split-rate method of lowering the tax on land and increasing it on structures was the exact opposite of what this committee was working on, but **Sen. Stonington** pointed out it was the other way around and therefore in line what they were trying to accomplish. **Chairman Devlin** stated the issue they were facing dealt with properties located in high-growth areas where the existing homeowner had no control over rising values; market forces raised the value of their property to the point where they could no longer afford the tax burden. He added the committee had looked at taxing structures at 100% of value, and reducing the location component of the tax equation as a way to solve this problem, explaining the value of the structure would not rise as dramatically in a popular area unless the homeowner intentionally made improvements warranting a higher tax liability. **Rep. Bitney** felt the article was provocative in that it was quite subjective; he questioned the 'steady decline' in property taxes and wondered if government spending was up substantially. He also wondered about the statements that there had been increases in state and federal funding in areas that had traditionally been funded by property tax and asked what effect the decline in school enrollment had. **Ms. Cooney** referred to an article she had read which also talked about taxing the land and not the improvements (structures). This new concept dealt with growth issues and carried societal implications but she did not know of any state that had implemented this as of yet.

Sen. Story recalled that **Dave Bohyer** had included relevant information in his presentation at the very first meeting; copies of it were in the members' packet. **Chairman Devlin** commented that according to school administrators, property taxes used to make up the bulk of their funding but, as the aforementioned article said, those had steadily decreased in recent years, and schools were looking at revenue sources from

gaming, license fees and similar activities. He compared property taxes to vehicle taxes: the latter had been in place for many years, until the car's value rose above \$10,000; there was not a lot of sympathy for someone who owned such a high-priced vehicle in the 'sixties. The general feeling was if someone could afford to buy such a car, he could also afford the taxes. Since car prices today generally start at \$20,000 and the old way of taxing vehicles made such a purchase prohibitive, the Legislature was forced to make an adjustment and came up with the 'flat fee' tax. And now, the same phenomenon was happening with high-priced properties; owners of such properties were not getting any sympathy, either, except that now, most people find themselves in this situation where they cannot afford to own property anymore, and something has to be done about it. **Sen. Stonington** contradicted his analysis and said while car prices were similar in different regions, the purchase price for property was not; it depended entirely on the location. **Sen. Toole** recalled a map showing counties such as Wibaux and Petroleum where property values had surprised the members. **Chairman Devlin** affirmed this, saying that during the last reappraisal cycle, some of the largest percentage growth in the state was in the poorer counties, such as Blaine, Hill, and Toole. He added his own county, Prairie, saw a 23% increase in residential property value, well above the state average. They were also among the few to see a decrease in commercial Class 4 property. He stressed the highest concentration of property value increase was not in the Flathead Valley but in Gallatin and Madison County, and the ones in Flathead and Lake County were not clustered around the lake but spread throughout the county. **Ms. Cooney** asked the members to remember these differences were based on percentages; they could be seeing a 100% change in Blaine county where a value of \$1,000 could be going to \$2,000; the difference in dollars might not be as significant. She added she had looked at all the counties to see where the last local reappraisal had taken place and found that Phillips County did not have a big change. Blaine County came out just below market value because of the limited number of sales since the previous reappraisal. She explained that as a rule, land values are set within neighborhoods but there were times when it was necessary to go outside of a jurisdiction to find enough of a sales pool to develop a rationale. One caveat was these had to be of equal economic value. **Sen. Story** made the comment that people wanted their vehicle taxes cut but as long as there was no decrease in spending, revenue sources would have to shift to such things as income tax or what was left of the property tax base. He felt this committee's goal was not to cut taxes but find solutions, which were revenue neutral. **Chairman Devlin** reiterated the charge of this committee was to study the effects of reappraisal, and in the course of their discussions, the unpredictability in the state's tax structure had become apparent. Whatever market forces were at play over a six-year period, all of a sudden things can change dramatically, and the property owner had no way of predicting those changes. He stressed they were charged with looking into whether this could be eased, keeping in mind that the \$800 million raised through property taxes are funding the state's basic services; thus, their recommendations cannot be to simply lower the taxes but to maintain them and at the same time, provide some protection and predictability to the individual property owner so he will not be forced to sell because he can no longer afford the taxes.

Chairman Devlin proposed a 15-minute break after which they would forge ahead into the next day's agenda, and then take public comment.

■ recess from 2:50 p.m. to 3:05 p.m.

The first item on the next day's agenda was the Department's ideas for change. **Ms. Cooney** gave the committee an overview of Brad Simshaw's analysis, which had been presented to the Governor's Office prior to the last legislative session; it dealt with the separation of the land and improvement exemptions with regard to residential property, attempting to seek improvements while retaining revenue neutrality. She read from **Exhibit 3**, page 12, of a revenue estimate for the tax year 2002 with the tax rate 3.46% and the exemption on residential property was 31% for both the land and the improvements. She explained all of the data in this document referred to Class 4, with tax class 4.1 being residential improvements and tax class 4.2 referring to the land. The chart displayed the 2002 reappraisal value, the exemptions, the 2002 market value after application of the exemptions, the tax rate, the taxable value, and 101 mills at the state level, bringing the revenue estimate to \$74 million. The box below shows the estimate for 2008, and if the same tax rate and exemption was in place, the revenue estimate would rise to over \$89 million. This data had triggered discussions in the last session on what had to happen to prevent this substantial increase to taxpayers and resulted in SB 461. This is manifested in the next box, which shows the same tax year of 2008 with the impacts of reappraisal fully phased in, and the committee's recommendations for an overall neutral tax rate of 3.0% and exemptions of 34% for both residential improvements and land. **[Tape 3, Side A]** The last scenario results in almost the same estimated revenue retaining a tax rate of 3%, but is based on a 29.5% exemption for residential improvements and a 45.2% exemption for residential land. **Sen. Stonington** asked if this referred to the one acre on which a structure sat or if it referred to land up to 20 acres. **Ms. Cooney** repeated this represented the entire Class 4 and could be any acreage up to 20. **Sen. Story** surmised this analysis was an attempt to retain the same revenue amount in 2008 as in 2002, except that it shifted \$3 million to the land reappraisal after the exemption rate had been changed to 34%. **Chairman Devlin** asked **Rocky Haralson** to expand on how the reappraisal value for land and structure is determined. **Mr. Haralson** replied the land value is determined from either vacant land sales within the neighborhood or by applying a process called abstraction or allocation on improved sales if there is a scarcity of vacant land. Once the land values are determined, his office analyzed improved sales by removing the predetermined value of the land. This isolates the structure and will yield adjustments based on any improvements done to it, such as an additional bedroom or bathroom. **Sen. Stonington** wondered how this was done with non-qualified agricultural land, a 30-acre parcel for instance, where the market value was substantially higher than the appraised value. **Mr. Haralson** explained non-qualified agricultural valuation was either set by statute or by administrative rule; in a scenario of a larger than 19-acre parcel which would automatically qualify its land value, the law dictates one acre be removed and valued the same as one acre in a 15-acre parcel. As for the non-qualified agricultural land, which cannot be analyzed in a value set from the market modeling aspect because land values are not correct and true but dictated by statute or law, the cost approach to value is applied. **Chairman Devlin** referred to the proposed adjustments of putting more of the tax burden on the structure and asked whether this would cause the DOR to look at cost approach more than market model.

Mr. Haralson said it would not because an attached rate was applied which meant it was done after the determination of the value aspect.

Ms. Cooney then went over the first scenario in *Exhibit 3*, p.13, explaining these revenue estimates were also for the year 2008 with tax rate of 3% but a lower exemption for residential improvements at 27.7%, and a residential land exemption at 50%. Referring to **Sen. Story's** comment regarding taxable value, she noted this caused a slightly larger shift to residential improvements from residential land. The next scenario yields an example of what would happen if improvement exemptions were removed entirely while a 100% exemption was applied to the land. This would shift the entire tax burden onto the improvements; the revenue estimate in this scenario stood at \$81 million.

The last scenario took this one step further: in order to attain a revenue neutral system while entirely exempting land, calculations showed the improvement exemptions would have to be at 8.4%. The estimated revenue derived from that was about \$74.5 million. She asked the committee to consider that any change in exemptions for land or improvements created a shift in the tax burden from one to the other, as **Sen. Story** had pointed out.

The next two pages contained in *Exhibit 3* and labeled (a) and (b), were graphs produced by **Brad Simshaw** during the last session. They illustrate statewide results produced by lowering the improvement exemption to 29.5%, and increasing the land exemption to 45.2%. She explained the first page dealt with percentage changes while the second page used estimated tax dollars. The chart in the upper left of the first page (a) displayed the estimated impact of the 2003 reappraisal on residential property taxes paid, fully phased in with adjustments. Based on these numbers, 54% of taxpayers are facing lower taxes, 46% higher taxes, and a total of 30% of taxpayers have a change of 5% or less in tax liability. After adjustments were made to achieve taxable value neutrality, the chart below showed a slight shift to where 60% see a decrease, 40% would face an increase, and about 28% will see change of 5% or less in their taxes. Page (b) is based on the same data but displays dollars rather than percentages. The upper chart showed 54% of residences had a decrease in taxes while 46% were facing an increase and, in the chart incorporating the adjustments it was again a 60/40 ratio. She concluded by saying this information was preliminary and only served as a guide to possibly separating land and improvement into two different exemption categories. **Sen. Story** observed there was not a lot of difference in the number of people who saw increases in their tax liability driven by improvements than by an increase in the land value. **Sen. Stonington** asked **Judy Paynter** to explain why they had decided not to separate the land value from the improvements. **Ms. Paynter** stated it was the land value that was driving up the cost in most areas; in other areas such as around Yellowstone Park and the Madison River, the reason for the higher cost was the value of the improvements. This was exactly what made it so hard to find a system that was fair to everyone; it was not uniformly a land issue. **Sen. Story** commented this created another sub class for Class 4, namely residential, commercial, and land. **Sen. Stonington** wondered whether commercial property was given land exemptions as well. **Ms. Cooney** was not certain but thought the exemption was not extended to commercial property. She noted the information

presented went as deep as they had prepared it for this meeting with the idea to show the committee what had happened to date so they could take it further if they so decided.

Chairman Devlin stated the one issue which always came before the Tax Committee was this: a property owner had done minimal improvements to the structure which he had owned for a number of years but saw a dramatic increase in the property value. In this case, it was the land that drove up the value since it was in a desirable location. He favored taking another look at finding ways to make the taxes more equitable but wondered if it would create legal problems if it was done with residential Class 4, and not commercial Class 4. He asked **Rocky Haralson** if commercial property was appraised in the same way as residential. **Mr. Haralson** replied that they were valued the same; and zoning and other factors which might affect the valuation of a particular parcel were analyzed. As an example, he mentioned properties on North Montana, such as Bon-Macy's and Target, saying these parcels of land would not be selling for the same amount as same size parcels along the railroad tracks or in the industrial areas East of town. He explained once this supply and demand aspect, tied in with location, was weighed, cost approach for the structure and improvements thereon was determined, and then his office factored in the income approach to value for the improvements. **Chairman Devlin** asked how much work it would be to create a chart similar to these, but separating commercial from residential improvements. **Ms. Cooney** affirmed these data were available and asked if she should display them at a county or state level. The chairman felt a statewide comparison would be more in line with the charts presented today and was promised such a chart would be available by the March meeting. Having listened to the issues of location and land versus improvements, **Mr. Haralson** asked to clarify the following: in the appraisal practice, the principal substitution comes into play when a buyer will not pay more for something for which he can get a lower priced substitute and this does not just impact the land. The land itself is not a big issue but replacement cost is. The fact that a homeowner in Chinook would see a gradual increase in the value of his properties over a six year period is to be expected; to build that same structure, just from a replacement cost aspect, would cost more unless there is a severe economic downturn, and most residential properties, regardless of location, will increase in value over a period of time because of this. Even though location can be a driving attribute, increases take place in rural areas as well. The land may remain fairly stable, but replacement costs will be much higher. **Chairman Devlin** stated houses in his area were located on agricultural land; the home sites were separated out and had a state value assigned to them. He asked whether a cost depreciation approach was used to determine the value of these residences, and not the market model approach. **Rocky Haralson** confirmed cost approach was used with regard to agricultural properties; the value was set by statute according to productivity. *[Tape 3, Side B]* **Sen. Story** claimed if residential land was exempt from taxation, it would create a behavioral change: people will build their homes on much bigger lots which would change the make-up of neighborhoods and would be contrary to a developer's goal of creating high density subdivisions. **Rocky Haralson** stated this was a valid point, and it referred back to **Sen. Stonington's** questions about 20 or 30-acre parcels. And it was the reason past legislatures gave any parcel over 20 acres an agricultural valuation; and any property between 20 and 160 acres was put into the non-qualified agricultural land category for which the tax rate is seven times as much. To

obtain the benefit of this tax rate, subdivisions of 20.1 or 20.5 acres were created. He stated this issue had been addressed to a certain degree by past legislatures and asked if this committee wanted to further study solutions and their possible effects. He explained a 20.5-acre parcel that would sell for \$50,000 in the Helena area is actually being valued at \$25,000 for the first acre, and the remainder would be valued grazing grade. He advised the committee because of this fact they needed to look at the actual sales value and how it was impacted.

Sen. Story asked whether the \$ 4 – 5 million in the charts represented all lots up to 20 acres. **Mr. Haralson** confirmed. **Ms. Cooney** added that the charts also included lots with home sites in the non-qualified parcels to which **Sen. Stonington** had alluded. **Sen. Story** surmised if the land was exempt, acreage would go from 20.5 down to 19.5 or 19.9 because the owner would not be assessed the ‘seven times grazing’ fee. **Sen. Stonington** wondered what kind of behavioral incentive land exemptions in Class 4 would create, and pointed to the current incentive to subdivide at 20 acres because of the tax law. **Sen. Story** felt the 20-acre parcels had less to do with taxes but with the make-up of subdivisions, and the tax system followed. The legislature wanted to put a stop to the 20 acre tracts and raised the limit to 160 acres; this then encompassed all the properties over 20 acres which before had escaped the subdivision law. It was not feasible to put 160 acres into market value; some other mechanism had to be found, and that was how they arrived at classifying parcels between 20 and 160 acres as non-qualified agricultural land and assessed the ‘seven times grazing’ fee. He felt in retrospect, this might not have been the right decision as some of this land probably was prime irrigated land and had been valued at \$800 or \$1,000 before, and when it went to non-qualified agricultural and dropped to ‘seven times grazing’, the property owner, in effect, received a tax reduction. He did not think this committee wanted to deal with this aspect. He cautioned if the committee intended to incorporate exemptions, they needed to consider not exempting the one-acre on which a home was built and which held the well and the septic tank, and to come up with some other method of taxing the remainder of the land. He added it was conceivable someone would subdivide the 20 acres into two-acre lots to qualify for the exemption, but that would result in a big political battle. **Sen. Stonington** injected this scenario was exactly what she had envisioned, that someone would retain ownership but subdivide the land into small lots to escape taxation. **Chairman Devlin** advised this kind of thinking was the reason the committee needed to gauge and anticipate the taxpayer’s response to any changes they might propose. He added they would be dealing with perception problems as in the case of two similar structures, one located on a lot and the other on 19 acres, and which they were taxed at the same rate.

Sen. Story asked **Jim Stack** to shed some light on this problem. **Mr. Stack** referred to the residential tax liability distribution chart on page (a), **Exhibit 3**, saying at 25 to 30, the number in the right column was 94.4% which meant approximately 5.6% still saw an increase of over 30% in their tax liability. He stressed this was no different in the same percentage that was sought under current legislation, and it did not matter whether one looked at percentage or the dollar figures: one in twenty-one taxpayers would see a 30% increase. If the land exemption increased to 45%, it would not help the majority of property owners; it might take out some but pull others in, especially those with big

houses on small parcels of land. In order to help those with a high land impact, the exemption would have to be 60% or 70% and that would upset a good portion of constituents because of the increase in property taxes. He noted if this committee was to pass out a proposal containing absolutely the minimum impact and accomplishing the protection of the land, they needed to take a look at the solutions Michigan and Florida had adopted and apply them to the land only. If the inflation rate was applied just to the land portion of the appraisal, the committee would accomplish their goal, and the tax shift to the improvements would be negligible. He stated a \$150 per square foot house would be comparable anywhere in the state's metropolitan areas, and was certain any increase in improvement liability would be a one-time impact. **Sen. Stonington** claimed all of this did not solve the problem of replacement cost. **Mr. Stack** agreed, saying any new construction replacing an old or destroyed structure would in fact be appraised at new construction or market value. **Chairman Devlin** commented this came back to what **Sen. Story** had alluded to earlier: even though the percentage in a district stayed the same, a different group of property owners would be impacted, and he added the committee would certainly take a look at the idea of phase-in inflation caps on land value only.

Ms. Cooney noted one topic for this or the next day's meeting was other states' reappraisal cycles and the fact that all of them indexed by a sales ratio study so that they were at current market value. She said she would invite a discussion about removing the phase-in limit and re-introducing a sales ratio study in Montana for the purpose of simplifying the process. She touched on a second topic, based on recommendations by a group from Kalispell and a request by **Sen. Barkus** and distributed *Exhibit (c)*. The committee decided to discuss these recommendations since both **Mr. Stack** and **Mr. Mahler** who were members of that group, were present. **Ms. Cooney** read from the page which included the following:

1. The interim committee was to seek a long-term solution which will make property taxes predictable for all Montana residents
2. Revisit legislation as passed in SB 195 (phase-in limit) and SB 184 (land value cap) and modify them by resolving any flaws
3. With or without broader tax reform, the interim committees should consider property tax solutions which had been adopted by states such as Michigan and Florida (Here **Jim Stack** commented one of the reasons the sales tax had been voted down by people living in the 'hotbed areas' was the fact that with it, property tax might be cut in half initially but people knew it would go up again with the next reappraisal cycle or legislative session, leaving them without tax relief)
4. The Montana Department of Revenue should be requested to research and recommend possible ways to reduce or eliminate the classification or exemption inequities in property taxes which are giving tremendous tax breaks to out-of-state and/or wealthy property owners, such as increasing the minimum acreage for qualification as non-Class 4 property or by adopting different tax rates for homestead versus non-homestead ranches and farms; revisiting the income qualifications to reduce tax benefits for "recreational" ranches; or setting a minimum percentage of water frontage which must be included for contiguous properties on which a residence is built and non-Class 4 qualification is claimed

5. The Montana Department of Revenue should be requested to supply a complete listing (without owner name or assessor number for confidentiality reasons) and an analysis of those properties which will see more than a \$2,000 increase in Taxable Value by 2008 under SB 461

She advised the Department was in the process of compiling this information at **Sen. Barkus'** request. The qualifications in SB 461 said property owners had to experience an increase of more than 25% in taxable value, and a \$250 tax liability, and **Sen. Barkus** had asked them to look at properties with a \$500 tax liability [*Tape 4, Side A*] as well as to separate in-state from out-of-state owners.

Sen. Stonington stated one of the dilemmas had always been what to do about the \$1,500 income tests on properties that were not really used for agriculture but were qualified as such. It was her impression this was a one-time test, and it would merit a discussion. She also suggested looking at the reasons for arbitrarily designating a 20-acre parcel for a 'seven times grazing' fee while someone with just a half an acre less paid residential taxes based on full market value. She recalled many pertinent discussions but no solutions and asked the committee to look at some of the recommendations such as income qualifications and minimum percentage of water frontage. **Sen. Story** opposed looking too deeply into the water frontage issue as it was destined to create even more acrimony. He preferred staying with a narrower focus. He claimed political perception killed the 'land cap' method and cited the large house on one of the Flathead Lake islands as an example. In this context, he wondered if the 'land cap' could be applied on a residence the same as it was on a homestead. **Ms. Cooney** asked whether he referred to land-capping on 'owner-occupied' residences, and he replied the issue was whether to limit it to owner-occupied or extend it to everyone. **Ms. Cooney** explained the land-cap concept could be applied to anyone; applying it to only owner-occupied residences would raise the same type of arguments voiced during the session, namely pitting rental properties versus owner-occupied. **Sen. Story** argued the way the land-cap was structured was to value the land at a percentage of the value of the improvements thereon; for instance, the land under a \$300,000 house was still worth more than the land under a \$200,000 house, and that resulted in a lot of complaints. **Jim Stack** surmised it was making headlines around the state because 25% of the benefits went to out-of-state property owners; in fact, six out of the top ten beneficiaries, in dollar amounts, were non-Montana residents. He added they had talked to **Lee Heiman** about the land account and qualifying homesteads and explained he did not see a problem with it; basically, a land-cap was put in place to protect and promote neighborhood stability so that a Montana resident was not pushed off his property.

Seeing no further comments, **Chairman Devlin** inquired as to the time frame for **Sen. Barkus'** request, and **Ms. Cooney** felt comfortable with having the answers by the May meeting. The chairman recalled that the Revenue/Transportation committee had taken a brief look at the non-qualified agricultural issue, focusing on whether recreational ranches should be treated differently. He cautioned if this was done, they may end up with a proliferation of new classes, adding Montana already had the most property classes in the country, and he certainly did not want to add any more. He lauded the Legislature

for having made a conscious effort to bring most everything in line at a 3% tax rate and expressed concern that this committee was veering off into a different direction. He asked **Jim Stack** to clarify whether the qualifications for certain footage of contiguous water frontage property only referred to reappraisals of resort type property. **Mr. Stack** explained this was a problem which would most likely result in a constitutional challenge in that Montana's Constitution required "equalization between classes" which was somewhat vague, especially when faced with extremes such as properties on Flathead Lake where the average 100 foot (water front) appraised value is approximately \$300,000. Cromwell Island, for instance, is worth about \$20 million and is qualified under a variety of different classifications but all of them are over 20 acres and owned by one individual, and the whole island is assessed at \$78,000. This meant the person owning five miles or \$20 million worth of shoreline was paying one third of the property tax on his land that the average person on the lake paid. There were similar examples around Whitefish Lake; one owner had over 2,000 feet of water frontage but bought just enough land to get over 20 acres so that the land is not appraised on those 2,000 feet but taxed only on 100 feet; the other 1,900 feet are exempt from taxation under the lake shore category, and are taxed as timberland. He reiterated if one had enough money to buy any parcel in a contiguous 20 acres, they could jump through these loopholes. He agreed with **Sen. Stonington's** assessment that the 20-acre law was creating disparities, charging every realtor was aware of this loophole and advised his clients accordingly. To solve this problem, he suggested the Department talk to Scott Williams in the Flathead Valley DOR because this had been the biggest thorn in the Department's side for the last fifteen years; he might have some alternatives on how to equalize this situation. If those properties could be taxed more equitably, the revenue could go toward easing the property tax burden in the high-growth areas.

Ms. Cooney stated when the 20-acre rule was put into effect it was the size of most parcels and small ranchettes whereas nowadays, it was closer to 50 acres. She noted one solution would be to move the threshold upward and offered an analysis based on these data. **Chairman Devlin** recalled discussions leading up to the 20-acre rule, stating the line had to be drawn somewhere, and 20 acres were chosen at that time. He suggested the committee take a look at the \$1,500 threshold on qualified land that he felt was set too low, but to leave the basic concept intact. **Ms. Cooney** stated there were three classifications: any parcel under 20 acres; the non-qualified agricultural land which had to be between 20 and 160 acres and did not fall under "true ag"; and if it did, it should qualify under the \$1,500 level in order not to be taxed at the "seven times grazing" fee. **Sen. Story** asked how a 22-acre parcel of forestland would be taxed, and **Ms. Cooney** explained it would be taxed as such; the rule was it had to be greater than 15 acres of marketable timber. He then asked whether this land had to generate income, and was told it did not since it had its own classification. She added the tax rate on timberland was much higher compared to agricultural land and offered to prepare a comparison. **Sen. Story** was still not clear on the distinction, and wondered if he owned 25 acres of land designated as Class 4, subdivided it and built a house on it, would it still be Class 4. **Ms. Cooney** confirmed it would, barring any changes that would be affected by the new Administrative Rule with regards to agricultural land; if it contained marketable timber, it had to be classified as forestland and could not be put into Class 4. She explained once

agricultural land had covenants put on it, as for instance the gated community above Big Sky, it was taxed at market value under the new Administrative Rule since it had made the transition to Class 4 tract land. **Sen. Story** wondered, if one of these subdivisions was on 25 acres of agricultural land with covenants that prohibited running cattle on it, would it also go to market value. **Ms. Cooney** said it would, adding there were a few other criteria in the Administrative Rule, such as showing that the intent clearly was to cross into Class 4. **Sen. Story** probed further, asking if he bought 25 acres and built a house on it, the house and the one acre under it would be appraised at market value, and the remaining 24 acres would be assessed the 'seven times grazing' fee which **Ms. Cooney** confirmed. He took this a step further by painting the same scenario except this time, the 25 acres were forestland; he would be taxed at market value for the house and the one-acre, and the rest would be taxed as it had been before. **Ms. Cooney** replied the remainder would be assessed as forestland as long as there were no covenants and it held merchantable timber. She advised the timber statute was very clear; just because there were trees on the land did not automatically qualify it as timberland. While the tax on it was quite low at 1.39%, its value was considerably higher than agricultural land. **Sen. Story** asked her to do a comparison on an acre of timberland versus an acre of grazing land, and she promised to have it done for the next day's meeting. **Sen. Stonington** referred to the Gallatin River Ranch where one could buy a 15 or 20-acre parcel in a subdivision with covenants and common grounds, and asked if this then becomes classified residential tract under the new Administrative Rule. **Ms. Cooney** replied that it could be, depending on the covenants; if they strictly prohibited any agricultural activity, then it would cross over into Class 4. She added **Randy Pearson** could make a brief presentation on the new rules in the morning if the committee so desired.

Chairman Devlin asked for public comment on the afternoon's discussion. **Mr. Stack** referred to **Sen. Toole's** question about reverse mortgages, saying they had become a hot topic in the Flathead Valley this past summer and offered to put together information gathered from various lending organizations. The program was not popular since most retirees or those getting close to retirement viewed the equity in their property as their medical and/or retirement insurance. The last thing they want to do is put money back into their mortgage when they spent most of their lives paying it off. **Sen. Toole** stated what he was thinking of was building liability by deferring payments until the property transferred, but he was not sure if that was actually 'reverse mortgage'. **Mr. Stack** agreed that it was the definition of reverse mortgage; most retirees, though, saw this increase in debt as eating into their retirement. When asked by **Sen. Toole** whether they actually got cash, **Mr. Stack** explained they did not, the reverse mortgage program paid their property taxes. **Rep. Bitney** noted there were two different subject matters; one, where a property owner needed financial help and the bank disbursed a certain amount of money per month, and the other was the deferral of the tax liability or reverse mortgage, and he asked **Mr. Stack** to shed some light on this distinction. **Mr. Stack** explained a financial institution would set up any program depending on whether money was needed to pay the taxes or to cover taxes plus living expenses, based on an annuity table. **Sen. Story** opined the state already has such a program for people over a certain age, paying the taxes on a property and putting a lien against it; he wondered if the state charged interest on this as well. **Ms. Cooney** admitted she did not know off hand.

Mr. Dudley Mahler, Whitefish, rose and apologized for discounting the committee's accomplishments at the morning meeting. *[Tape 4, Side B]* He offered two more comments, namely that the people in his area were not looking for a tax decrease but for an assurance that their taxes were equitable, and that any increase in property taxes should go to benefit the state, such as help fund schools, and *not* to reduce their neighbors' taxes. He advised that he had done a lot of research into how the tax system could be modified and offered his database, charts and models to the committee to help with their deliberations. He felt revenue could be increased based on the necessary increases in appraised value; the state should stop depleting its tax base since this only lead to higher bills for the individual taxpayer: he reasoned when an increase could not be spread over a large base, the individual's tax bill would increase.

Absent of any more comments, **Chairman Devlin** adjourned the meeting at 4:45 p.m.

Minutes read and approved by

Representative Ron Devlin, Chair

Date

Senator Emily Stonington, Vice Chair

Date